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September 30, 1996

The Honorable Floyd D. Spence
Chairman, Committee on National Security
House of Representatives

Dear Mr. Chairman:

As you requested, we have reviewed the activities of the U.S.-China Joint Defense Conversion Commission (JDCC).[1] The JDCC was formed by the U.S. Secretary of Defense, in cooperation with China's Minister of the Commission of Science, Technology, and Industry for National Defense (COSTIND), to facilitate bilateral economic and technical cooperation in defense conversion and to maintain regular government-to-government contacts. However, since convening its first and only session in October 1994, the JDCC has sponsored only limited activities. In July 1996, the Secretary of Defense notified Congress that the U.S. government was terminating its involvement in the JDCC, citing the JDCC's inability to undertake broader activities.

To provide a historical perspective on the now-defunct JDCC, this letter discusses (1) the nature of defense conversion in China; (2) the benefits and costs of the JDCC; (3) whether JDCC activities assisted China's military modernization efforts; and (4) the steps taken by the Department of Defense (DOD) to safeguard U.S. security interests in light of the Chinese military's participation in the JDCC.

DEFENSE CONVERSION IN CHINA

China's approach to defense conversion has been to integrate military and civilian production through a range of activities: converting military facilities by turning over military assets, such as hospitals, schools, airports, and piers, to civilian use; attempting to spin off military technologies for civilian applications; and diversifying

[1]This letter is one portion of a response to your letter of February 23, 1996, requesting a series of reviews related to the potential risks associated with the transfer of sensitive U.S. technology to the People's Republic of China. Separate reports will be issued on the other parts of your request.

by combining military and civilian production in military factories.[2] A unique aspect of China's defense conversion is the military's becoming involved in civilian businesses. According to several specialists, China's primary emphasis appears to be on diversification. A 1992 United Nations (U.N.) study on defense conversion[3] concluded that China's aim was to create dual-use (military and civilian) capacity–rather than straight conversion away from military production–with factories able to produce war materiel when needed. China's military industry has been involved in manufacturing consumer items, including bicycles, cars, medical instruments, textile machinery, television sets, and washing machines, according to the U.N. study. Some military enterprises have also diversified by investing in, or merging with, civilian-oriented enterprises, such as hotels, real estate, restaurants, foreign trade, and farming.

COSTIND is the chief body in the Chinese government responsible for defense conversion. Along with several different and sometimes competing organizations, COSTIND acts as a bridge between the military and civilian authorities. COSTIND directs defense conversion efforts, assisted by two subordinate organizations, the China Association for Peaceful Use of Military Industrial Technology[4] (the Association) and the China Defense Science and Technology Information Center. With the Association–which promotes public relations, provides information, develops connections with other countries, and sponsors exhibitions and seminars–COSTIND has led China's defense industry to undertake a full-scale public relations effort to find investors and markets. However, some China specialists suggested that COSTIND's authority may be waning. (See the enclosure for more detailed information on COSTIND's role in China's government.)

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[2]"Conversion" involves the transfer of resources and the reorientation of productive capacities from military use to civilian purposes. "Spinoff" refers to a military contractor's attempts to utilize technologies for civilian purposes that were developed originally with military applications in mind. "Diversification" is usually understood as a broadening of a company's production line and also sometimes refers to the efforts of a region or community to reduce its defense dependence by encouraging companies to shift into nonmilitary production or by attracting new firms to the area.

[3]See Michael Renner, Economic Adjustment After the Cold War: Strategies for Conversion, U.N. Institute for Disarmament Research (Hants, England: Dartmouth Publishing Co., Ltd., 1992).

[4]One source identified the Vice Minister of COSTIND as the honorary Chairman of the Association.

BENEFITS AND COSTS OF THE JDCC

The JDCC's overall benefits and costs were modest, in keeping with the limited scope of its activities. DOD officials highlighted three benefits of the JDCC for the United States: (1) providing the U.S. military contact with the Chinese military, (2) potentially increasing U.S. companies' commercial opportunities in China, and (3) improving the transparency (openness) of the Chinese military-industrial complex. For example, the JDCC's primary initiative was to promote cooperation in modernizing China's air traffic control system, according to JDCC documents and officials. The JDCC sponsored three bilateral delegations on air traffic control. The delegations included Chinese and U.S. military officials and thus provided opportunities for their interaction. The Chinese delegation to the United States met with representatives from U.S. companies interested in business opportunities in China.

Other ways the JDCC sought to increase commercial opportunities for U.S. businesses were to publish a directory of U.S. companies interested in defense conversion opportunities in China and a directory of projects in China seeking U.S. business involvement. However, U.S. government officials told us they were aware of the JDCC's fostering only one commercial transaction that resulted in the export of a U.S. commodity to China. This lack of commercial activity may be due to unresponsiveness on the Chinese side, perhaps in part caused by periodic tensions and uncertainties in Sino-American relations. For example, the Chinese stopped participating in the JDCC's air traffic control project in April 1996, effectively suspending the initiative in the planning stage. U.S. officials were aware of two other cases in which U.S. commercial organizations had made business overtures to the Chinese, but received no response.

In July and August 1996 reports on JDCC expenditures and activities, DOD said that JDCC-related expenditures from August 1995 through July 1996 had come to about $55,600. A DOD official estimated that related expenditures for the lifetime of the JDCC probably would total about $100,000.

JDCC ACTIVITIES AND CHINA'S MILITARY MODERNIZATION

We found no evidence to suggest that JDCC activities resulted in the transfer of U.S.-controlled technology or finances that would benefit China's military modernization. A Department of Commerce review of completed U.S. export license applications for 1995-96 revealed that Commerce had not issued any export licenses for dual-use items to 15 specified Chinese facilities whose representatives visited the U.S. West Coast in December 1995. We did not independently verify Commerce's analysis.

U.S. government officials provided no evidence that the U.S. government or U.S. companies had given financial assistance to JDCC defense conversion projects proposed by China or that DOD had ever intended to request funding for such uses. They knew of only one JDCC project that had successfully linked a Chinese and a U.S. company, and it involved exporting a U.S. commodity not controlled as a dual-use item. U.S. officials affiliated with the JDCC said that they did not systematically track whether U.S. and Chinese companies initiated business dealings as a result of JDCC activities, but they received information through informal channels.

U.S. government officials told us that, if the air traffic control initiative to modernize China's air safety system--suspended since April 1996--were to go forward, it would not represent an improvement in China's military capabilities of significant concern to the U.S. government.

SAFEGUARDS PROTECTING U.S. SECURITY INTERESTS

U.S. government officials and documents identified the U.S. export control system as the primary safeguard against illicit transfer of technology from JDCC defense conversion projects to Chinese military modernization purposes. It is the policy of the United States to restrict the export and reexport of items that would make a significant contribution to the military potential of any other country or combinations of countries that would prove detrimental to the national security of the United States. In addition, the U.S. export control system restricts exports of items and technologies that could lead to the proliferation of chemical, biological, and nuclear weapons, and of missiles.

In addition to U.S. export controls, DOD's Defense Technology Security Administration (DTSA) conducted a review of 49 JDCC projects proposed by China to identify potential exports of restricted items and technologies. DTSA raised concerns and requested additional information on 23 of the projects, based on its initial review. DTSA officials said their concerns resulted from a lack of adequate technical information about either the projects or Chinese companies. They said DTSA analysts were unable to perform as thorough a review as they would for actual export license applications. DTSA's review of various proposed projects promoted by a Chinese defense conversion delegation visiting the West Coast in December 1995 under JDCC sponsorship resulted in some reservations regarding potential projects. Most of the West Coast projects had been listed in the China Directory. However, DOD noted that none of the projects of concern to DTSA were carried out. In addition, by performing its reviews, DTSA was able to look at technologies that potentially might appear on export license applications and to record its concerns before the Commerce Department received any applications.

In the fall of 1995, DOD officials stated that the JDCC would monitor contacts between U.S. and Chinese companies that resulted from JDCC-related activities. However, JDCC procedures did not require the JDCC to monitor private sector

contacts. Commerce and JDCC officials stated that they did not monitor such contacts but learned about some on an ad hoc basis. DOD officials participated in all JDCC bilateral delegations in China and the United States, according to DOD's 1996 reports on JDCC and our review.

AGENCY COMMENTS

DOD reviewed a draft of this letter and concurred with the information it contained. Commerce generally agreed with the letter, but suggested some clarifications, which we incorporated as appropriate.

SCOPE AND METHODOLOGY

To obtain information for this letter, we reviewed documents from the Departments of Defense and Commerce relating to JDCC meetings, delegations, and projects. We spoke with officials of the Defense, Commerce, and State Departments; the Arms Control and Disarmament Agency; the Federal Aviation Administration; the Lawrence Livermore National Laboratory in Livermore, California; and the U.S. Defense Attaché's Office of the U.S. embassy in Beijing, China. In addition, we spoke with representatives of private U.S. companies with business interests in China, and with analysts of China at Stanford University in Palo Alto, California; the Monterey Institute of International Studies in Monterey, California; and the RAND Corporation in Santa Monica, California. We also reviewed the literature on China's defense-industrial complex. We did not contact all of the U.S. companies, or any of the Chinese companies, that participated in JDCC delegations; were listed in JDCC directories; or may have used JDCC directories to initiate business contacts. We did not independently identify what, if any, business contracts, exports, or financial arrangements might have resulted from JDCC delegations or directories.

We conducted our review from March 1996 to August 1996 in accordance with generally accepted government auditing standards.

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As arranged with your office, we plan no further distribution of this letter until 10 days from its issue date, unless you publicly announce its contents earlier. We then will send copies to the Secretary of Defense and other interested congressional

committees. We will make copies available to others on request. The major contributors to this letter were F. James Shafer, Jeff Phillips, Hynek Kalkus, and Amy Finkelstein. Please contact me at (202) 512-4128 if you or your staff have any questions.

Sincerely yours,

Benjamin F. Nelson

Benjamin F. Nelson
Director, International Relations
and Trade Issues

ROLE OF THE COMMISSION OF SCIENCE, TECHNOLOGY, AND INDUSTRY FOR NATIONAL DEFENSE (COSTIND) IN CHINA'S GOVERNMENT

COSTIND is the chief body in the Chinese government responsible for defense conversion, according to China specialists and studies. In addition, it is in charge of coordination and management of military research and development and production of new weapons and technologies.

The head of COSTIND reports to two commissions: the Central Military Commission of the Chinese Communist Party, which directs the uniformed services of the People's Liberation Army (PLA), and the planning commission of the State Council, which directs defense-related and supporting industrial corporations and ministries. While China specialists indicated that the senior memberships of these bodies overlap or are virtually identical, one specialist noted that the Central Military Commission appears to have more authority. COSTIND works with the State Council on military production goals and funding decisions.

China specialists indicated that COSTIND, along with several different and sometimes competing organizations–the Equipment Bureau of the PLA's General Staff Division, and the foreign trade companies that are part of the military bureaucracy–maintains the link between weapons factories and the uniformed PLA. China's military-industrial complex is comprised of institutions located in the PLA and in the ministries that report to the State Council, which is separate organizationally from the military. The Central Military Commission has primary authority over the military enterprises of the PLA, which manufacture primarily consumer and low-technology civilian industrial products, while the State Council has primary authority over the state-run ministries and corporations, which are run and staffed by civilians. COSTIND provides guidance and coordination to the ministries and corporations, plans and assigns–in conjunction with the General Staff and Logistics Departments of the PLA and the state planning commission–defense production requirements to factories and acts as a bridge between the military and civilian authorities. COSTIND sets an overall agenda for weapons-related research, development, and production; provides the research institutions with requirements for new systems; and coordinates with the weapons factories. On an organizational level, COSTIND is equal to the Ministry of National Defense and other ministries, but above the level of the corporations subordinate to the State Council.

China specialists noted that COSTIND directs defense conversion efforts, assisted by two subordinate organizations, the China Association for Peaceful Use of Military Industrial Technology and the China Defense Science and Technology Information Center. It has been the ultimate focal point for decisions concerning defense conversion. Both the civilian and military sides of the defense industry defer to COSTIND. However, according to some China specialists, COSTIND's authority may be declining. COSTIND also has subordinate trading companies, as well as think tanks or

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information centers. In addition, COSTIND directly supervises the work of a number of research institutes dedicated to nuclear weapons research, development, testing, and production.

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